THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE OFFICE OF ENERGY AND
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Secretary

SCOTT J. SOARES
Acting Commissioner

Dairy Farm Revitalization Task Force

Approved Meeting Minutes
August 24, 2007
Lord Jeffrey Inn
Amherst, MA

Task Force Members Present:
Ms. Lynne Bohan, processor representative
Representative Daniel Bosley, House of Representatives
Mr. Dwayne Breger, Department of Energy Resources designee:
Mr. Jay Kuhlow, Senator Stephen Brewer, Senator's designee;
Mr. Mark Duffy, farmer representative
Ms. Ellen Fitzgibbons, Department of Public Health designee;
Mr. William Gillmeister, Ph.D. appointee, Department of Agricultural Resources
Undersecretary Philip Griffiths, EEA Secretary's designee;
Representative Stephen Kulik, House of Representatives
Senator Michael Knapik, State Senator
Senator Stanley Rosenberg, Senate;
Mr. David Shepard, Massachusetts Cooperative of Milk Producers Federation representative;
Mr. Scott Soares, Acting Commissioner Department of Agricultural Resources;
Mr. Richard Woodger, Massachusetts Association of Dairy Farmers representative

Members of the public were also present

**1. Call to Order:**

Acting Commissioner Scott Soares called the meeting into order at 9:44 AM. He asked the members to introduce themselves.

**2. Approval of August 24, 2007 Meeting Minutes**

**Motion:** Dr. William Gillmeister made a motion to approve the minutes. Representative Bosley seconded the motion.

**Discussion:** None

**Vote:** Unanimous

## 3. Old Business:

### a. Draft Report Scheduling

Acting Commissioner Scott Soares reviewed and proposed a schedule and rough outline for drafting the report. After the meeting on September 7, the introduction and activities of the Task Force will drafted. This portion will include the options considered and the information that was gathered at each of the three meetings of August 10, 24, and September 7. This introduction and considered options will be drafted in time for review and public comment during the morning portion of the meeting on September 21. The afternoon portion of the meeting will focus on making a decision as to what specific options the Task Force will include in its recommendation. Once the Task Force makes that decision, the draft report will be completed with those recommendations incorporated into it. One week later, on September 28th, a draft of the final report will considered by the Task Force for final approval to be submitted to the legislature.

No objections were made to this proposal.

### b. South Carolina Income Tax Credit

Acting Commissioner Soares then broadly introduced the topics for the remainder of the day's agenda as focusing on revenue generating options, the first of these being the S.C. refundable income tax credit.

To present this program, Acting Commissioner Soares introduced the first speaker, Mr. Larry Boyleston. Mr. Boyleston holds a BS and MS degree in Agricultural Economics from Clemson University. He is presently the Assistant Commissioner at the South Carolina Department of Agriculture and Director of its Agricultural Services Division. He also assists Hugh Weathers, the South Carolina Commissioner of Agriculture with agricultural policy, legislative issues and administration.

In his introductory comments, Mr. Boyleston pointed out that the South Carolina Dairy Tax Credit had a somewhat misleading name because many dairy farmers have little to no tax liability. So what good is a tax credit where there is no tax liability? He explained that the program is a refundable tax credit, that is, after the tax liability has been deducted from the tax credit, the remaining portion of the credit is refunded to dairy farmer. He also noted that the actual legislation was quite simple and amounted to less than one page.

With that introductory comment, Mr. Boyleston provided a PowerPoint presentation on the Dairy Tax Credit. The program is a safety net program that provides a refundable tax credit of $10,000 for the first 500,000 pounds of annual milk production and a $5,000 credit for each 500,000 pounds of milk production afterward. The tax credit is awarded whenever the milk price falls below a minimum price, called the Production Price, during any one month of a quarter. To claim the credit, dairy farmers merely need to perform some rather simple calculations on their annual tax returns and wait for the refund to be deposited into their accounts. In 2005, the program refunded nearly $2.8 million dollars to South Carolina dairy farmers with an average payment of approximately $20,000.

Mr. Boyleston pointed out some salient features of the program. The program is limited to farms with greater than 500,000 pounds of milk production per year. This amounts to a minimum farm size of about 28 cows. The legislation requires that the program take into account milk prices paid to farmers in surrounding marketing areas. It had to account for transportation costs of hauling milk from outside the area, and finally, the program had to take account of the cost of producing milk. Using these factors, a Production Price was calculated. To determine whether the tax credit applied to a given quarter, the actual price was compared to the Production Price and if the actual price fell below the Production Price for any one month during a quarter, the credit would be applied to an entire quarter's worth of annual production. Mr. Boyleston's presentation included an example to demonstrate the mechanics.

Two years with this program, Mr. Boyleston reports that no one has complained about it. In fact, he claimed that the most recent National Agricultural Statistics Service reported that South Carolina had a very strong increase in milk production during the second quarter of 2007. The original legislation requires a report be submitted to the legislature after two years. The South Carolina Department of Agriculture will be developing that report over the next few months.

Task Force members asked a significant number of questions.

**c. Risk Management: Livestock Gross Margin-Daily**

Acting Commissioner Soares introduced the next speaker, Dr. Bruce Babcock, professor of economics and the Director of the Center for Agricultural and Rural Development at Iowa State University. Dr. Babcock holds a Ph.D in agricultural and resource economics from the University of California at Berkley. Dr. Babcock's research interests primarily focus on understanding agricultural commodity markets, the development of innovative risk management strategies for farmers, agricultural and trade policy analysis, and impacts of biofuels on U.S. and world agriculture.

Dr. Babcock began by illustrating what livestock gross margin insurance was not. At one end of the spectrum, is a fixed target price support mechanism requiring significant regulatory intervention and funding. He cited the Milk Income Loss Contract program as an example of this type of policy. A middle ground approach is a moving target price that requires somewhat less regulatory intervention and funding and cited the South Carolina tax credit as an example of such a program. Finally, at the other end of the spectrum is a market determined target price, which requires much less regulatory intervention or funds. This is the livestock gross margin (LGM) insurance model.

He then explained that the newly approved livestock gross margin insurance program for dairy. The Board of the Federal Crop Insurance Corporation had just approved this insurance program at the end of July. The policy provides protection against "…unexpected declines in gross margin (market value of milk minus feed costs) on target quantity of marketed milk." This is accomplished by using the Commodity Mercantile Exchange futures prices for milk, corn, and soybeans to determine the expected or anticipated or better still, the guaranteed level of gross margin on the expected quantity of milk to be marketed over a certain period of time. With the expected gross margin locked in, the LGM policy covers the difference between the guaranteed margin and the actual margin realized by the farmer whenever the difference is negative.

Dr. Babcock then described the rules of the policies. The farmer can purchase a policy on any amount of milk during any month of the calendar year for durations of up to 11 months excluding the month just after the purchase of the policy. For example, a farmer may decide to purchase a policy on the sale day in January. The policy does not cover the month of February, but begins coverage in March and lasts for next ten months, or 11 months in all including March. The farmer may choose a shorter period, but the month following the purchase date is not covered.

Taking data for the years 2002 through 2004, he constructed an example of how a policy would work if a farmer purchased it in January. He ran through comparisons of projected and actual milk prices, corn prices, and soybean prices for each of the years. In 2002, actual milk prices fell below the expected price used to calculate the guaranteed margin in the policy, and the corn and soybean prices were higher than expected with the result that the gross margin fell below the guaranteed margin for each of the eleven months of the policy. In the end, the policy would have paid $2.52 for each cwt of insured milk.

In 2003, actual milk prices rebounded after several months of being below the projected price while corn and soybean prices yielded similar tendencies, that is, in some months the expected price was below the actual and others the expected prices were above actual. Therefore, the actual gross margins were above the guaranteed margin and no payment was made, while during other months, the gross margin was below the guaranteed and the policy paid. In 2004 the actual margins ended up well above the guaranteed margin and no payments were made. In some years, the policy will pay while in others it will not.

Dr. Babcock then turned to the premiums of the costs of the policies. The premiums will be higher in times of high price volatility and lower during periods of low volatility. As with any other insurance policy, the higher the deductible on the policy the lower the premium. The deductible in this case is the quantity of milk insured by the policy purchased. Insuring 100% of the milk will result in a higher premium than insuring a lower percentage of the milk. Finally, the longer the term of the policy purchased the lower the premium.

Once again, Dr. Babcock provided an example to illustrate the range of premiums. He assumes a 100 cow heard producing 1,500 pounds per cow per month with 9.4 tons of corn and 7.7 tons of soybeans per month. To insure 100% of the milk, that is, no deduction, the premium would come to just over 80 cents a cwt with a total cost of the policy of just over $12,000. As the deductible increases, that is, the amount of the production insured falls, the premium falls. Therefore, a deductible of $1.00 per cwt, the premium rate falls to just less than 40 cents or $6,000. Similarly, by insuring for longer terms, the premiums fall by an average of about 20 cents per cwt. In terms of price volatility, as volatility increases the premiums increase by as much as 40 cents.

As Dr. Babcock concluded his presentation, Task Force members asked questions about various aspects of the insurance policy. Some questioned the applicability of the policy to Massachusetts on a number of grounds. Ultimately, Dr. Babcock noted that the policy is revenue neutral in the sense that farmers who purchase the insurance and do so over a long period of time, eventually get back out of the policy what they've paid in premiums. That is the way it was designed.

### d. Maine Program

Acting Commissioner Soares introduced the next speaker, Mr. Stan Millay. Mr. Millay holds a B.S. degree in Public Administration from the University of Maine. He is presently the Executive Director of the Maine Milk Commission and most recently assisted in dealing with the Maine dairy crisis of 2006 that led to revisions of Maine's Dairy Support program. He also administers Maine's Milk Control Laws and manages the State's milk pool.

Mr. Millay began by sharing his insights into the impact that the Maine program has had on the Maine dairy industry. He stated that Maine has 350 dairy farms and 30,000 cows that produce 590 million pounds of milk annually. The dairy sector maintains approximately 4,000 jobs. The program has stabilized the dairy industry even through the difficult circumstances of 2006.

He proceeded to describe the background and history of the program as well as how it functions. In 2003, Maine established a Task Force, similar to that of Massachusetts, to investigate the long-term sustainability of the Maine dairy industry. Several recommendations were made in the final report. Maine's response was to establish two separate programs.

First is the Milk Handling Fee. The processor pays this fee, and the amount of the fee is on a sliding scale depending on the Announced Federal Order Class I price in Boston (Class I price). The fee structure recently changed, and Mr. Millay explained that the sliding scale begins when the Class I price falls below $24 per cwt and the fee is two cents a gallon. An additional two cents is added to the fee if the Class I price falls below $23.00 per cwt, that is, the fee is four cents. For each one-dollar drop in the Class I price 2 cents is added to the fee, until it drops below $18.00. Then four cents is added. When the Class I price drops below $17.00, then four cents is added to each 50-cent drop until the Class I price falls below $15.00 per cwt. At that point, the fee increases by six cents for each 50 cent drop in the price below the $15.00. The fee is collected by the Maine State Tax Assessor's Office and is deposited directly into Maine's general fund. In 2006, under the old sliding fee schedule, the Tax Assessor's Office collected $3.3 million dollars.

Second, Maine has established a Dairy Stabilization Program. The program provides a safety-net payment to dairy farmers whenever the farm price falls below a set of Target Prices. The Target Prices are based on costs of production and other factors and are tiered based on farm size. Smaller farms have a higher Target Price and therefore, begin getting payments before larger farms. The Dairy Stabilization Program paid $11.5 million to farmers in 2006, but paid as little as $600,000 dollars in 2005 when market conditions were much stronger.

Acting Commissioner Soares noted that it was just after 12:00 PM, and called for a motion to recess for lunch.

**Motion:** Dr. Gillmeister motioned to recess the meeting for lunch. Richard Woodger seconded the motion.

**Vote:** Unanimous.

The meeting recessed at 12:01 P.M.

Acting Commissioner Soares called the meeting back to order at 1:21P.M.

**e. Panel Discussion on Maine Model**

Mr. Soares proceeded to introduce Stan Millay, Brian Houghton, John Blake and Galen Larrabee who were each invited to make a 5-minute statement of introduction.

<u>Mr. John Blake (Consultant, H.P. Hood):</u> Mr. Blake began by stating that milk processors are worrying about the decline in sales as prices rise, despite milk showing a great elasticity. He also noted that we have seen a shift in more private labels of milk. Also, there is increased competition

among beverages with other/similar health claims. Mr. Blake went on to state that Maine's newest handler fee is untested; the old fee (1-12 cents) versus the new fee (2-36 cents). This new fee caps out at $15/cwt. $13 milk would have a $0.60/gallon premium and that would constitute a big disparity among sister states. Maine also regulates its wholesale and retail sales, so you need to make sure processors are on board and not about to fiddle with prices. Mr. Blake believes that before looking to adapt a similar program in Massachusetts, we should take a close hard look at a regional approach instead.

Mr. Brian Houghton (Massachusetts Food Association): Discussed what affects the Maine program has had on its members. He also noted that some cost increases have occurred. He also stated that members have sensed a problem along Maine's border areas; because a loss in sales is seen when prices rise in comparison to neighboring communities/states, which his association feels has been applied fairly across the board. Non-retailers are concerned that one specific commodity (class I) is receiving a subsidy, but all products should receive subsidies especially if we are trying to save the dairy industry as a whole. Retail prices do not affect what producers are getting. He also stated that non-retailers need to deal with more regulations because states are coming up with their own individual programs that need to be kept up with.

Mr. Galen Larrabee (Maine Dairy Farmer): Began by stating that the dairy industry in Maine would have been significantly different if they had not implemented this program, especially as their costs are dramatically higher than in other areas of the U.S. He went on to say that the Maine program provides stability and that a new generation of young farmers has flourished in the state. He also described how the program originated and that presently both government and its citizens are happy with this program. Mr. Larrabee also noted that in a recent statewide survey of 600 people, 95% of the people in Maine wanted dairy to stay in the state. He finished by stating the Maine system is based on our costs; it's a three-tier system based on farm size. The program does not guarantee us a profit, but we ought to be in the same category and not settle for 'barely getting by.

Significant discussion occurred after Mr. Larrabee finished his comments. Topics included retail price increases, sales and demand for fluid milk and other products, as well as price gouging, and the movement of milk produced in Maine to other states. Recent retail price increases due to the rapid and unprecedented milk price increases raised several concerns, not the least of which is whether such price increases will result in a decrease in demand. The panel seemed to think that some response would result, although it was too early to determine. Mr. Blake and Mr. Houghton saw general trends in milk consumption versus other beverages as an issue rather than just simply price impacts. Ms. Bohan stated that she may be able to get studies on elasticities. A point was also made that fluid milk consumers are carrying the burden of supporting the dairy farmer, while consumers of other products such as cheese and butter do not. This raises the question of whether to consider a broader tax than on just fluid milk.

Discussions of why retail milk prices seemed to have risen more than that justified by the farm milk price increases raised several points. One point is that if retail prices have moved strongly but have not seriously impacted consumption, then a three or four cent charge on milk to assure dairy farmers a living wage would not seem to be unreasonable.

Price gouging was another topic that arose regarding retail milk prices. New York's price gouging law was discussed and Mr. Millay stated that he thought that Cornell was in the process of a study to determine whether price gouging laws assisted farmers in any way. This lead to Dr. Ron Cotterill's price collar model. That model, which was first proposed several years ago, would set a markup threshold of say 180% of the mark milk price. If the retail markup rose above the threshold, then a certain portion of the excess would go back to the farmer. Various concerns were raised about Dr. Cotteril's model ranging from administration of such a program to interstate commerce clause issues. Furthermore, Mr. Blake noted that the likely response from retails would be to limit price markups on milk to 180%. This, of course, leads to nothing being returned to the farmer.

In the discussion, panel members brought up the fact that 50% of the milk produced and subsidized, through the dairy stabilization program, was being shipped outside of Maine. That would be a concern in Massachusetts, but not likely to arise because Massachusetts is a milk deficit state not a surplus state such as Maine. That is, little farm milk produced in Massachusetts leaves Massachusetts.

Finally, Mr. Blake noted that the new set of fees for Maine had not been in place long enough to determine the impacts. He suggested that there may be some resistance to these new fees once milk prices begin to fall and the fees are assessed.

**4. New Business:**

Acting Commissioner Soares stated that he does not have any new business. The only other task force member who introduced new business was Mark Duffy who requested that Dr. Ron Cotterill be present at one of the upcoming meetings if possible.

**5. Public Comment:**

Acting Commissioner Soares opened discussion up to the public. Mr. Warren Facey noted that to place a fee on other dairy products such as cheese and butter would be too difficult to track. Assistant Commissioner Kent Lage asked a few questions regarding the importance of the minimum prices set by the Maine Milk Commission. Mr. Millay stated that the such minimum prices are an integral part of the process.

**6. Adjourn:**

Noting no other business or public comment, Acting Commissioner Soares called for a motion to adjourn.

**Motion:** Dr. Gillmeister motioned to adjourn the meeting. Undersecretary Griffiths seconded the motion.

**Vote:** Unanimous

The Meeting Adjourned at 3:32 P.M.